

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Ruth Y. Goldway, Chairman;
Mark Acton, Vice Chairman;
Nanci E. Langley; and
Robert G. Taub

Competitive Product Prices
Inbound Competitive Multi-Service Agreements
with Foreign Postal Operators
Canada Post Corporation–United States Postal Service
Bilateral Agreement (MC2010-34)
Negotiated Service Agreement

Docket No. CP2012-4

ORDER ADDING AN ADDITIONAL BILATERAL AGREEMENT TO INBOUND
COMPETITIVE MULTI-SERVICE AGREEMENTS WITH
FOREIGN POSTAL OPERATORS 1 PRODUCT

(Issued December 30, 2011)

I. INTRODUCTION

The Postal Service requests to add a specific agreement to the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product established in Docket No. MC2010-34. For the reasons discussed below, the Commission approves the request.

II. BACKGROUND

On December 9, 2011, the Postal Service filed a notice, pursuant to 39 CFR 3015.5, that it has entered into an additional bilateral agreement with a foreign postal operator which it seeks to add to the Inbound Competitive Multi-Service

Agreements with Foreign Postal Operators 1 product.¹ The Notice concerns the portion of a bilateral agreement with Canada Post Corporation for inbound competitive services (Canada Post Agreement).

In Order No. 546, the Commission approved the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product and the Koninklijke TNT Post BV and TNT Post Pakketservice Benelux BV (TNT Agreement). The Postal Service asserts that its filing demonstrates that the Canada Post Agreement fits within the Mail Classification Schedule (MCS) language in Governors' Decision No. 10-3 originally filed in Docket Nos. MC2010-34 and CP2010-95. Notice at 3. Additionally, it contends that the Canada Post Agreement is functionally equivalent to the agreement filed in Docket No. CP2010-95. *Id.* at 5-6. In Order No. 840, the Commission approved the functionally equivalent Norway Post Agreement and the designation of the TNT Agreement as the baseline agreement for purposes of functional equivalency analysis of the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product.²

The Postal Service also filed supporting materials including a redacted copy of the Canada Post Agreement, supporting financial documentation, and an application for non-public treatment of materials filed under seal.

The Canada Post Agreement covers, *inter alia*, the delivery of inbound Air Parcel Post (Air CP) and Expedited Parcels USA. Notice at 3. The Postal Service's Notice states that the parties intend for the rates to become effective January 1, 2012, and to remain in effect for 2 years. *Id.* at 4, Attachment 1 at 1. The Canada Post Agreement may be terminated without cause with 90 days' notice. *Id.* Attachment 1 at 8.

¹ Notice of United States Postal Service of Filing Functionally Equivalent Inbound Competitive Multi-Service Agreement with a Foreign Postal Operator, December 9, 2011 (Notice); see also Docket Nos. MC2010-34 and CP2010-95, Order Adding Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 to the Competitive Product List and Approving Included Agreement, September 29, 2010 (Order No. 546).

² See Docket No. CP2011-69, Order Concerning an Additional Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 Negotiated Service Agreement, September 7, 2011 (Order No. 840).

The Postal Service contends that the Canada Post Agreement to deliver inbound Air CP and Expedited Parcels USA in the United States is functionally equivalent to the agreement to deliver inbound Air CP and EMS in the TNT Agreement. *Id.* at 5. The Postal Service asserts that the Canada Post Agreement is similar in both product and cost characteristics to the TNT Agreement. *Id.* It states that the TNT Agreement includes similar terms and conditions, e.g., is an agreement with a foreign postal operator and conforms to a common description. *Id.* The Postal Service identifies differences that distinguish the instant Agreement from the TNT Agreements, but asserts that these differences affect neither the fundamental service the Postal Service is offering nor the fundamental structure of the agreement. *Id.* at 5-6.

The Postal Service contends that the TNT Agreement incorporates the same cost attributes and methodology, and the relevant cost and market characteristics. *Id.* at 6. Despite some differences, the Postal Service asserts that the Canada Post Agreement is functionally equivalent to the TNT Agreement previously filed. *Id.*

In its Notice, the Postal Service maintains that certain portions of the Canada Post Agreement, prices, and related financial information, should remain under seal. *Id.* at 3, Attachment 4.

The Postal Service concludes that the Canada Post Agreement complies with 39 U.S.C. 3633. *Id.* at 6. Therefore, it requests that the Commission add the Canada Post Agreement to the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product. *Id.* at 7.

In Order No. 1057, the Commission gave notice of the docket, appointed a Public Representative, and provided the public with an opportunity to comment.³ Chairman's Information Request No. 1 sought clarification of the unit costs and volumes used in the Postal Service's financial workpapers filed under seal.⁴ In addition, the Postal Service

³ Notice and Order Concerning Filing of an Additional Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 Negotiated Service Agreement, December 19, 2011 (Order No. 1057).

⁴ Chairman's Information Request No. 1, December 21, 2011 (CHIR No. 1).

was asked to provide a rationale for using the unit mail processing cost for Industrialized Countries (ICs) rather than a Canada Post-specific unit cost.

The Postal Service responded to CHIR No. 1 on December 27, 2011 and filed a revised version of a footnote supporting its financial documentation.⁵ The Postal Service explained that its unit mail processing cost is a weighted average that incorporates both the ICs and Canada Post. The revised footnote explains this. The Postal Service also expresses concern that the Canada Post sample size for processing EMS may be too small because Canada Post only started using EMS at the end of August in FY 2010 with the fiscal year ending September 30, 2010. The Postal Service concludes that the best estimate should include both ICs and Canada.

III. COMMENTS

Comments were filed by the Public Representative.⁶ No other interested person submitted comments. The Public Representative reviewed the Canada Post Agreement's functional equivalence with the TNT Agreement in Docket No. CP2010-95 and compliance with 39 U.S.C. 3633(a). *Id.* at 2. He states that the Canada Post Agreement has specific differences as identified in the Postal Service's Notice that do not affect the fundamental service or structure of the agreements. *Id.* at 3.

The Public Representative also maintains that although the Postal Service did not demonstrate that the addition of the instant Agreement results in the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product covering cost as required by 39 U.S.C. 3633, the Postal Service's financial model indicates that the negotiated prices in the Canada Post Agreement will cover costs.

⁵ United States Postal Service Response to Chairman's Information Request No. 1 and Notice of Filing Non-Public Materials, December 27, 2011 (Response to CHIR No. 1).

⁶ Public Representative Comments on Postal Service Notice of Filing an Additional Negotiated Service Agreement for Inclusion Within Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1, December 23, 2011 (PR Comments).

However, the Public Representative has concerns about the unit costs used and the contingency factor used by the Postal Service in the financial model accompanying the Canada Post Agreement. *Id.* at 4. The contingency factor is applied to cost estimates and provides for unforeseen circumstances during the contract period. *Id.* at 4. The Public Representative notes that the Postal Service selected a lower contingency for the instant contract compared with the contingency factor used in the financial model for the baseline TNT Agreement. *Id.* Additionally, the Public Representative questions the use of mail processing unit costs for industrialized countries (excluding Canada) to develop the cost estimates in the financial model. He observes that both the contingency selected and the unit cost used produce a more favorable cost coverage. *Id.* at 3-4.

IV. COMMISSION ANALYSIS

The Postal Service proposes to add an additional agreement to the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product. First, the Commission reviews the Agreement to ensure that it is functionally equivalent to the agreement approved in Docket No. CP2010-95, and thus is properly included in the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product. Second, the Commission must ensure that the instant Agreement satisfies the requirements of rules 3015.5 and 3015.7, and 39 U.S.C. 3633.

Functional equivalence. The Postal Service states that the Canada Post Agreement shares similar cost and market characteristics with the TNT Agreement. It asserts that the instant contract meets the pricing formula and classification established in Governors' Decision No. 10-3, which comport with 39 U.S.C. 3633 and the Commission's rules. The Postal Service also identifies differences between the Canada Post Agreement and the TNT Agreement. These distinctions include more detailed provisions concerning the consequences of early termination and the processes to be used to protect Canada Post's confidential information when filed in regulatory or other proceedings in the United States. Notice at 5-6.

The Public Representative agrees that certain changes, as noted above, do not affect functional equivalence. PR Comments at 3.

The instant Agreement appears to be similar to the agreement filed in Docket No. CP2010-95, although it differs in some minor respects, relative to certain general terms. These differences notwithstanding, the Commission concludes that the instant Agreement is functionally equivalent and may be included in the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product.

Compliance with 39 U.S.C. 3633. The Commission reviews competitive products to ensure that they meet the applicable requirements of rules 3015.5 and 3015.7, and 39 U.S.C. 3633. Although the Public Representative acknowledges that the financial model complies with section 3633, he is concerned with the Postal Service's use of the mail processing cost for ICs excluding Canada Post and a low contingency factor. *Id.* at 4-5.

The Postal Service states that it used a unit mail processing cost that reflects both ICs and Canada Post. It used that combined unit cost because it only had 5 weeks of sample data for Canada Post since it did not start using EMS until the end of August 2011. The Commission agrees with the Postal Service's rationale. Five weeks of sample data may not be sufficiently large to be representative; thus, combining it with a full year's data for ICs is a reasonable approach.

According to the Public Representative, the Postal Service uses a lower contingency factor for the instant Agreement than it uses for a similar contract within the same product. It is difficult to anticipate how things may go wrong, but the Postal Service has some protection against adverse circumstances because it has used a contingency factor. This is a reasonable approach. In any event, the Commission will have the opportunity to assess the Postal Service's performance under the instant Agreement in future annual compliance determinations.

The Commission has reviewed the Notice, financial analyses provided under seal that accompanies the instant Agreement, responses to CHIR No. 1, as well as the comments filed in this proceeding. Based on the information provided, the Commission

finds that the Agreement should cover its attributable costs (39 U.S.C. 3633(a)(2)), should not lead to the subsidization of competitive products by market dominant products (39 U.S.C. 3633(a)(1)), and should have a positive effect on competitive products' contribution to institutional costs (39 U.S.C. 3633(a)(3)). Thus, a preliminary review of the instant Agreement indicates that it comports with the provisions applicable to rates for competitive products.

Other considerations. The Postal Service states that the parties intend for January 1, 2012 to be the effective date of the Canada Post Agreement. If this date changes, the Postal Service shall notify the Commission of the effective date. The Postal Service shall promptly notify the Commission if the Canada Post Agreement terminates earlier than its proposed term, but no later than the actual termination date.

In addition, within 30 days of expiration, or early termination of the Canada Post Agreement, the Postal Service shall file costs, volumes, and revenues data associated with the Canada Post Agreement.

In conclusion, the Commission finds that the Canada Post Agreement submitted in Docket No. CP2012-4 is appropriately included within the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product.

V. ORDERING PARAGRAPHS

It is ordered:

1. As set forth in the body of this Order, the Canada Post Agreement filed in Docket No. CP2012-4 is included within the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 (MC2010-34) product.
2. The Postal Service shall notify the Commission of the effective date of the Canada Post Agreement and update the Commission if the Agreement terminates prior to the scheduled termination date as discussed in this Order.

3. Within 30 days of expiration, or upon early termination of the Canada Post Agreement, the Postal Service shall file costs, volumes, and revenues data associated with the Agreement.

By the Commission.

Ruth Ann Abrams
Acting Secretary